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MONETARY REFORM

458 In the economic history of post-war Hungary August 1946 was a turning point. The country was drifting towards complete anarchy under the impact of an inflation the speed of which during the first half of 1946 surpassed anything hitherto experienced in this field. Its effects on the currency were devastating; it overthrew the entire price structure. In some respects the heavy strain placed upon the whole economic and social fabric by the intolerable wave of inflation helped to clear away difficulties in the way of the coming monetary reform. The accelerated collapse of the monetary system reinforced the intense desire for a return to a state of normality. Thus a psychologically favourable atmosphere for a new currency was created. Nevertheless it was a dangerous gamble with anarchy.

652 From a psychological point of view it was also relevant that the gold and foreign exchange reserves of the Hungarian National Bank (representing the value of 32 million dollars), which had been removed by the retreating Germans, were traced in the United States Occupation Zone of Germany, and returned in time by the United States authorities. Skilful propaganda advertised that the new currency would be backed by gold reserves at a pre-war rate (with a minimum of 25 per cent). The new monetary unit was defined in terms of fine gold contents,[1] but convertibility into gold was, of course, neither established nor ever intended. The obligation was imposed on the National Bank to see to the stability of the currency. The denomination of the new monetary unit—forint (florin)—was chosen so as to recall the tradition of the stable florin of Habsburg days, which was still remembered by the older generation.

At the outset it was the restricted supply of the new currency that induced the public to feel confidence in it. The value of the huge amount of pengö notes was practically annihilated, as their depreciation went far ahead of the pace of their issue. The supply of money depended, therefore, on the issue of forint notes. There was an initial issue of 300 million, to give the Treasury a breathing space until the reform of taxation became operative. The amount of 300 million forint was but a fraction of monetary requirements on the basis of prices and wages, which had been fixed in advance by reference to the price structure in 1938 as a 652 starting point. Nevertheless strict deflationary credit practices ● 457 were maintained at the beginning, compelling trade and industry to sell off stocks and also reserves of foreign exchange. Holders of foreign exchange were encouraged to offer it to the

[1] 1 forint = 0·0757 gramme of fine gold.

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National Bank by an amnesty put in force for a limited period, relieving them from the penalty for omitting to do so prior to the monetary reform. Draconic penalties were at the same time announced for any new infringement of the exchange regulations.

The psychological and technical devices worked. It soon became evident that the farmers accepted the new money. Something like a normal interchange between the urban and agricultural sectors of the community, an interchange which had been badly shaken by the preceding monetary disorder, was re-established.

Stabilization was, of course, backed by budgetary measures. A comprehensive fiscal reform of taxation, with the aim of restoring a budgetary balance, had been prepared in advance, and was evolved on broad lines out of the pre-war taxation system. Each source of revenue was to be exploited to the utmost.

Accordingly, rates of taxation were raised considerably as compared with those in force prior to the war. This relates both to the income and property taxes and to those on consumption. Incomes exceeding 1,200 forint a year (£24 though higher in purchasing power than in England) were liable to income tax. The rate was fixed at 2 per cent in the lowest range. Incomes of 10,000 forint are taxed at a rate of 6·7 per cent. The income tax reaches maximum rates of 70 per cent for income from work and 80 per cent for income from property. These highest rates weigh upon incomes exceeding 84,000 forint. A surtax with rates ranging from 15 to 75 per cent was payable on earnings (net of tax) above 18,000 forint. An increased tax on house rent amounted to 60–80 per cent of the gross rent, leaving only 20 to 40 to cover upkeep. The purchase tax was raised from the pre-war range of 2–5 per cent to 3–10 per cent. The company tax had to be paid according to turnover, irrespectively of whether there was any net profit. The pressure placed on the taxpayer may be seen from the fact that the interest on tax arrears has been replaced by a subsidiary tax at a *monthly* rate of 10 per cent. These efforts, coupled with a severe restriction of current expenditure on goods and services, produced a marked improvement of the budgetary position. Yet the burden of reparations amounting to 1,436 million forint out of a total expenditure of 3,701 million, prevented the Government from securing a real balance. The improvement attained after the first transition period of reorganized tax administration is illustrated by the rise of the contribution of taxes and other current revenue to total receipts from only 18 per cent in August and 47 per cent in September 1946, to an average of 78 per cent for the whole

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[651] budget year. Eventually 360 million forint had to be raised by 652 borrowing (60 million through the Postal Savings Bank in addition to the initial National Bank loan of 300 million) and 450 million from other extraordinary sources of revenue.[1]

The supply of currency, as reflected in the issue of bank-notes, is shown by the following figures:

	Million forint
31 August 1946	355·6
30 September 1946	606·6
31 January 1947	1,016·8
30 April 1947	1,258·2
31 July 1947	1,592·2

652 The renewed expansion of the circulation might prompt the
● 457 question whether the public, with the recollection of their recent experiences, would once again begin to distrust the currency. The stabilization was strictly confined to the internal value of money. In Hungary a system of exchange control had been in force as far back as 1931. This control naturally was taken over and maintained when an economy of shortage supervened at the end of the war. Transactions arising out of foreign trade were based on official parity rates in conformity with bilateral agreements.

In spite of heavy penalties a black market for foreign exchange and gold developed with rising rates. Apart from prosecuting the participants, in so far as they could be caught, the authorities did not interfere with the black market. There was, in particular, no direct intervention to influence the rates of this market. They were regarded by the authorities as isolated phenomena, unlikely to affect the general economic situation. This view was on the whole justified, for transactions in the black market were negligible.

652 However, by the autumn of 1946 an additional difficulty
[458] arose, endangering the balance between the amount of currency and the stream of goods. The poor harvest and the deficiencies of administration resulted in an acute food shortage and soaring prices. These price increases undermined confidence in the monetary reform, and black-market rates of exchange rose correspondingly. The upward movement was halted by a temporary credit restriction. A similar stiffening of the position developed in March 1947 in connexion with new difficulties in food supplies. It was checked by the same weapon of short-lived deflation. This was effected by enforcing the maximum limit of the note issue and by giving instructions to the National Bank

[1] These consisted mainly in the profit from the revaluation of the National Bank gold reserve and in the proceeds of the sale of goods obtained within the framework of UNRRA relief and the U.S.A. loan in kind.

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652 453 financial markets. Yet the break-up that ensued was calculated to sever existing links. The new State banking system was introduced gradually as from May 1948, and the old structure disappeared.

The entire current banking business was transferred to the National Bank which took over the assets and the liabilities of the other banks. Thus the Central Bank, endowed with the right of note issue, was turned into the exclusive source of credit. It provided enterprises directly with working capital through the instrumentality of the 'single-account' system. For an enterprise placed under this system, the National Bank had the monopoly of banking services. All its financial transactions had to pass through its single account. In particular loans providing working capital were credited to it.[1] From the outset nationalized enterprises and other public concerns came under the system. Any private enterprise, applying for credit to the National Bank or to the Treasury, might be drawn in, thereby being practically placed under public control.

Thus the National Bank came to provide for the financial requirements of the publicly-owned concerns and, to a considerable extent, also of those privately owned. For the residue of credit operations certain other institutions are assigned.

(1) An Investment Bank was established to finance and control investment activities in mining, industry, transport, and in important branches of building. The Bank is practically the financial section of the Planning Department. The funds at its command are derived first of all from the central and local government budgets. The amounts earmarked in these budgets for investment are transmitted to the Bank. It has at its disposal another source to draw upon for the purpose of allocating long-term credits: the National Bank. Finally it is the Investment Bank that handles the depreciation fund of Hungarian industry. All enterprises—public and private—pay regular contributions to this fund in proportion to their sales.[2]

652 457 (2) The Bank of International Trade was endowed with the monopoly of banking transactions connected with foreign trade. One of the former big Budapest banks, which, like the other banks, had already handed over all the other parts of its business to the National Bank, was established in this special capacity. However, in one respect the monopoly of the Bank for International Trade appears to be restricted; in transactions with Soviet Russia it is required to co-operate with the Russian-owned Hungarian Bank of Commerce and Industry.

652 453 (3) The National Savings Institution first operated as a section of the National Bank. In a second phase the section was promoted to

[1] The purport of this system from the point of view of financial control will be discussed in Chapter IX.

[2] See comments on p. 86, below.

185 X 434

A rate of increase in the national income in the order given, ambitious as it is, cannot be ruled out as impossible in a country like Hungary. But it requires continued, very heavy investments and also a great increase in productivity which, in its turn requires, besides investments, the redeployment of the labor force and very great effort on the part of the workers.

X

Investments

185 454

Twenty-one percent of the national income is earmarked for investments against 10 percent budgeted and 18 percent actual investments under the Three Year Plan and 3-7 percent in the interwar period. However, planned investments as given, did not include the increase in inventories. Before the war, with the national income increasing at a very much slower rate, the increase in inventories from one year to another was not considerable. In the case of the Three Year Plan, failure to account for them was a serious error in estimating the volume of goods available for consumption. If this practice has been adhered to, the same applies to the First Five Year Plan, even if stocks reached the prewar level at the end of 1949, which is doubtful.

Before the war, the volume of the national income increased by about 400-500 million prewar pengoes from one year to another. The estimated increase in inventories was around 180 million prewar pengoes, that is, it absorbed from one third to one half of the increment. The planned 40 billion increase in the national income at "plan prices" from 1949 to 1950 would thus require, besides the listed investments in plant and installations of 8.1 billion forints, an additional 3-4 billions to increase inventories. The volume of goods available for consumption would be correspondingly smaller. Another charge against the national income consists of reparations payments, at any rate until 1952. Although much reduced as a result of the Soviet decision to cut outstanding reparations by half from the middle of 1948, and the Hungarian decision to repudiate reparations due to Yugoslavia, they would still require about 0.6 billion forints in the first half of the plan period.

• [457]

In the investment plan, continued emphasis is given to manufacturing and especially to heavy industry, and budgeted investments for these branches of the economy total 21.3 and 18.3 billion forints respectively out of a total of 50.9 billion. Their percentage share is 42 and 36 percent. Agriculture is allotted 8.0 billion forints or 16 percent. Indirect investments benefiting agriculture bring its share to 12.5 billions or 25 percent. Transport and building receive 7.5 and 7.4 billion forints or 15